



ISLAMIC MODES OF FINANCE

by

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ISLAMIC FINANCIAL SYSTEM- AN INTRODUCTION

- Based on *QURAN* and *SUNNAH*
- Demands socio economic justice
- Prohibits all kinds of *RIBA*
- Prohibits all forms of exploitation
- Provides equal opportunities to all
- Condemns accumulation of wealth in few hands
- Encourages acts of benevolence

PRINCIPLES OF ISLAMIC FINANCE

- Prohibition of *RIBA*
- *Alkharajo bil dhaman* (entitlement to profit is associated with corresponding risk)
- *Prohibition of sale of goods before acquiring ownership*
- Prohibition of sale of food stuff before possession
- Prohibition of debt for debt
- Avoidance of *Gharar* (uncertainty)

PROHIBITION OF *RIBA*

● *QURAN*

○ “*ALLAH* has permitted *BAI*’ (sale) and prohibited *RIBA*”
(*Al Baqarah: 275*)

○ O you believers, fear *ALLAH* and give up whatever is left in lieu of *RIBA* if you are indeed believer, **Watch out!** If you do not obey this order (and give up all outstanding *RIBA*), then there is a **declaration of war** against you **from *ALLAH* and *HIS PROPHET.*** However, if you repent you have **entitlement only** to your **principals.** Neither you inflict *zulm* on others, nor the others should do *zulm* on you. (*Al Baqarah: 278-9*)

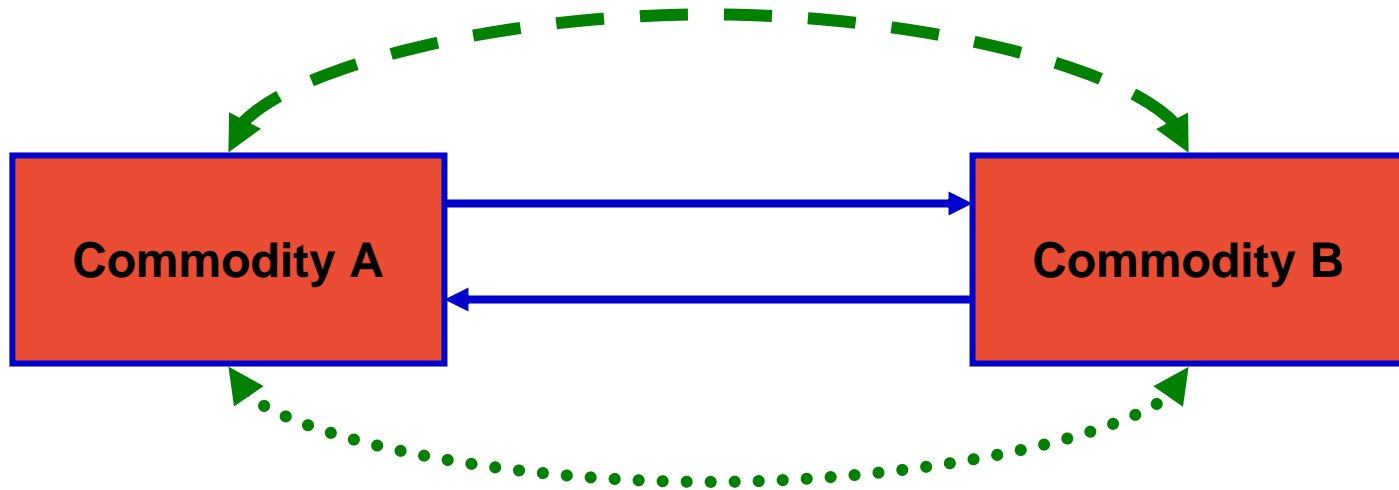
PROHIBITION OF *RIBA*

- *SUNNAH*

Obadah ibn Samit directly reports from the Prophet as saying: “**Buy and sell gold for gold, silver for silver, dates for dates, wheat for wheat, salt for salt, and barley for barley** on the **like for like** basis. Whosoever **gave** more or **took more**, verily he **made** a ***RIBA*** deal. However, trade **gold** for **silver** as you wish subject to the **condition** that the exchange be **hand to hand** (spot). Trade wheat for dates or barley for dates also likewise.

EXCHANGE OF HOMOGENEOUS COMMODITIES OR CURRENCIES

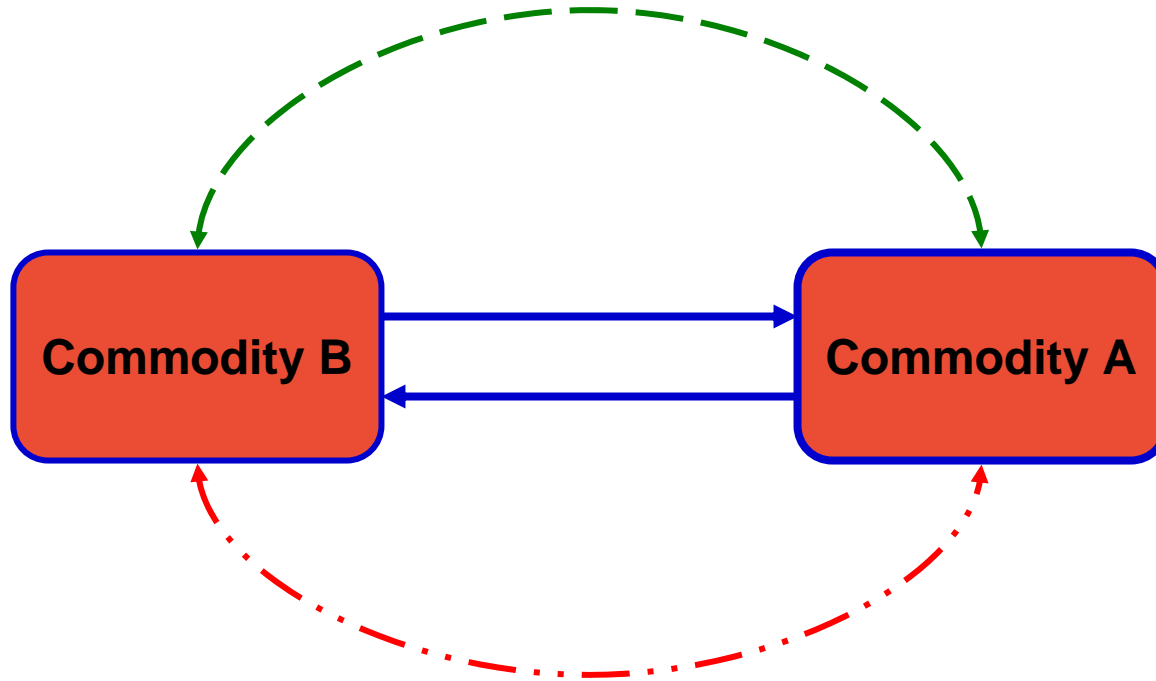
DELIVERY: Must be simultaneous / spot



MEASUREMENT: Must be same in amount / weight / count

EXCHANGE OF HETEROGENEOUS COMMODITIES OR CURRENCIES

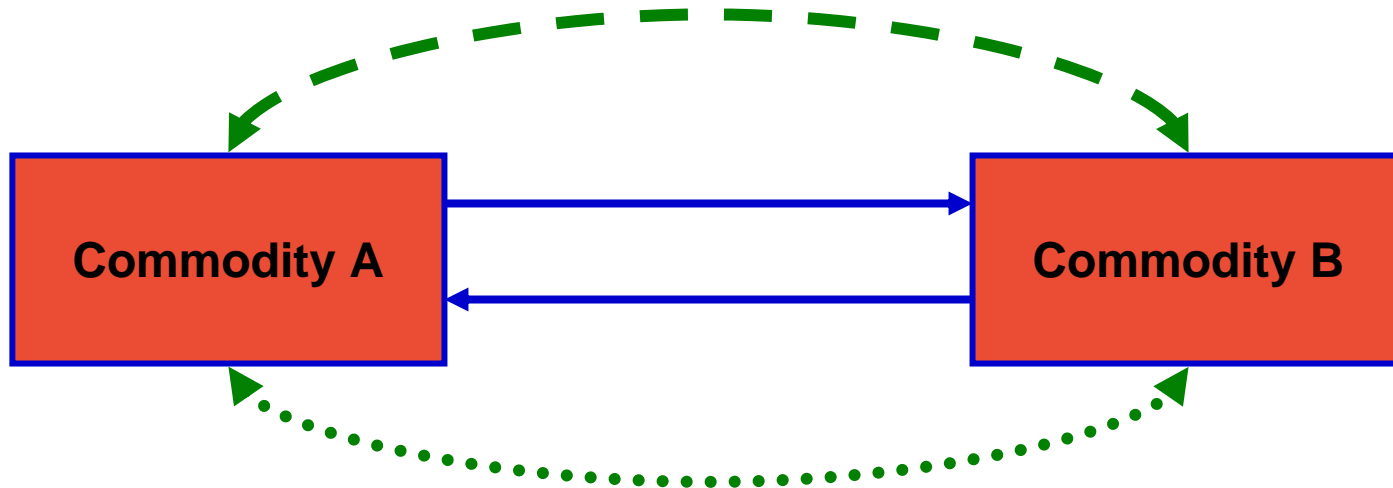
**DELIVERY: Must be
simultaneous / spot**



**MEASUREMENT: May be
different**

EXCHANGE INVOLVING *RIBA* IN HOMOGENEOUS COMMODITIES OR CURRENCIES

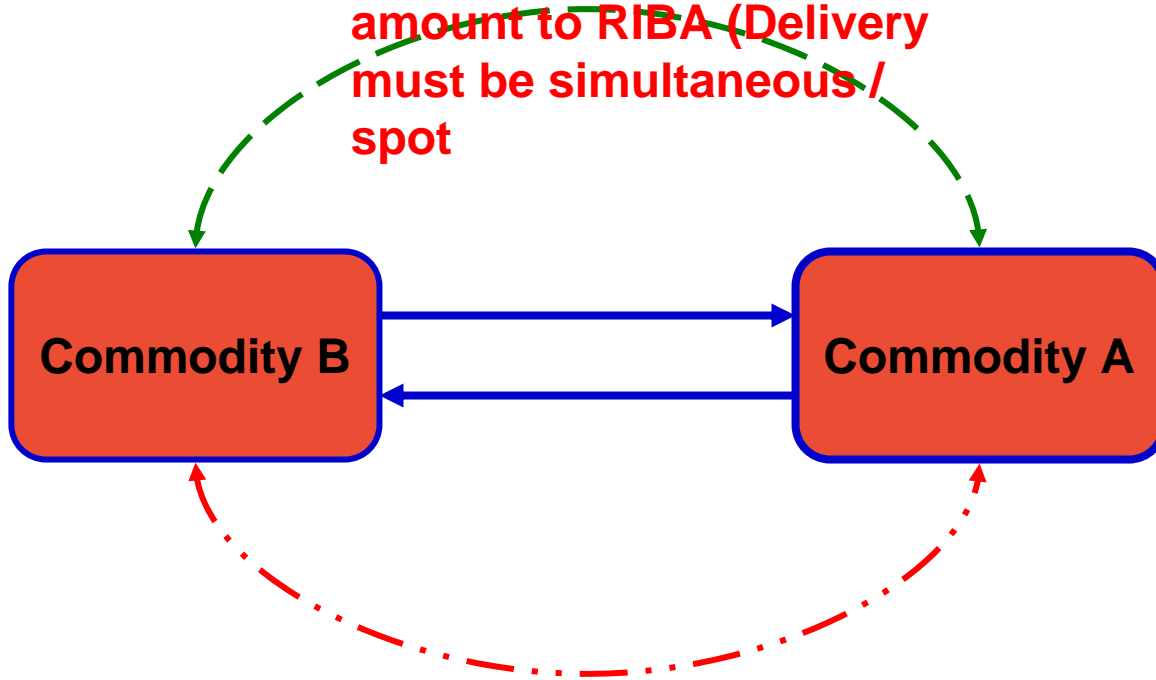
DELIVERY: Any one of the counter values is delayed



MEASUREMENT: Counter values are not equal

EXCHANGE INVOLVING *RIBA* IN HETEROGENEOUS COMMODITIES OR CURRENCIES

DELIVERY: Delay in any of the counter values would amount to *RIBA* (Delivery must be simultaneous / spot)



MEASUREMENT: May be different

Some principles derived from the *Hadith*

- General principles

- In a contract of sale counter values must be exchanged simultaneously
- Quantity /number/measure etc. should be same

- Exceptions

- Credit Sale
- Salam
- Qard-e-Hasanah

WHAT IS *RIBA*

- Simple definition

- Any delay or discrimination (regarding weight, measure or count) in any of the counter values in a contract of exchange is riba
- Any addition without a counter value is RIBA
- Every loan entailing an increase is RIBA

ISLAMIC CONTRACTS FOR COMMERCIAL TRANSACTIONS

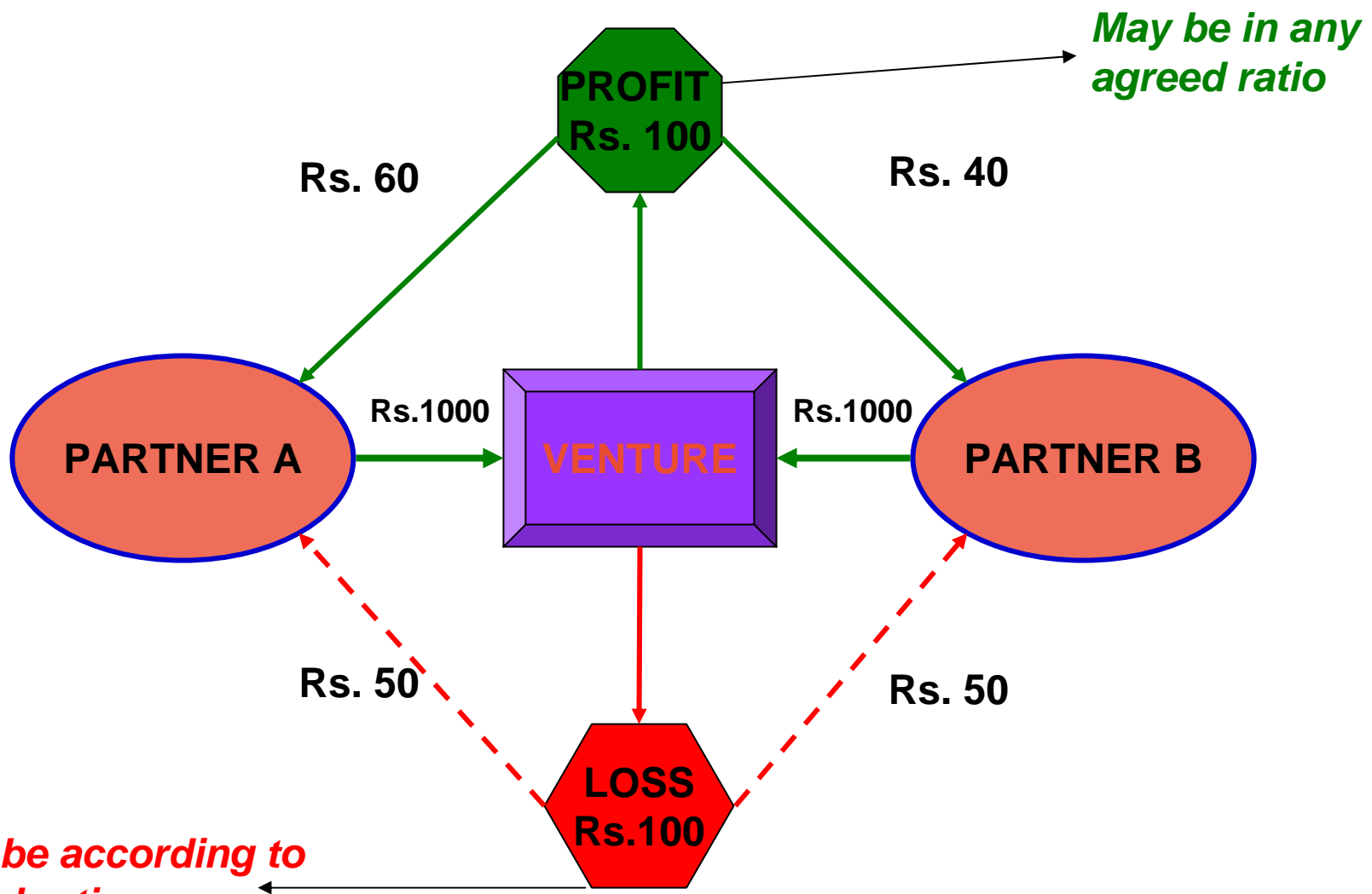
- Musharaka (Profit and Loss sharing)
- Modaraba (Profit sharing)
- Musawamah (Bargaining sale)
- Ijarah (Leasing)
- Salam (Advance payment sale)
- Istisna' (Contract of manufacturing)
- Murabaha (Cost plus margin sale)

MUSHARAKA

● Characteristics

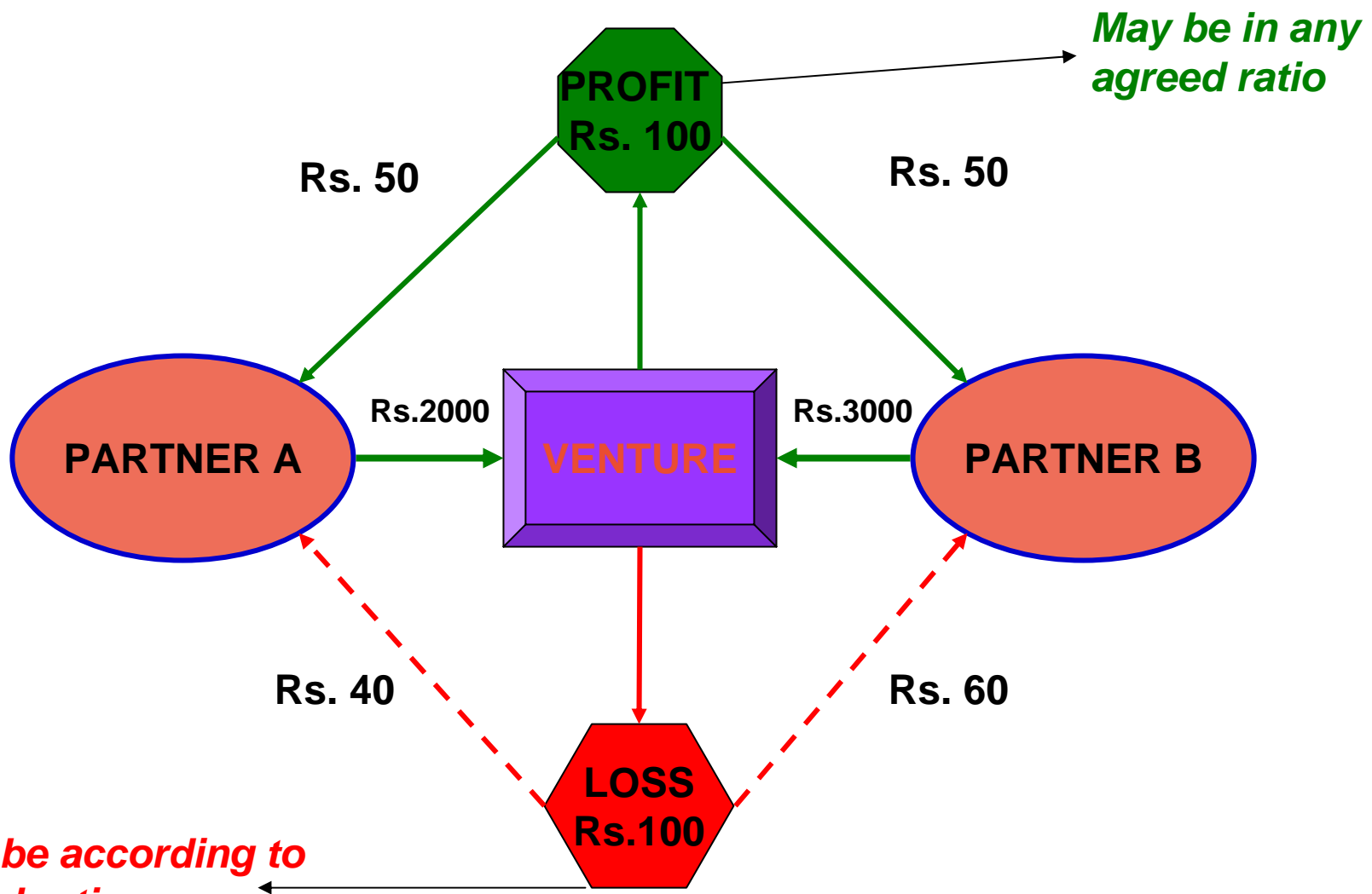
- All parties share in the capital
- All parties share profits as well as losses
- Profits are distributed as per agreed ratio
- Loss is borne by the parties as per capital ratio
- Every partner is agent of other

MUSHARAKA



Must be according to capital ratio

MUSHARAKA

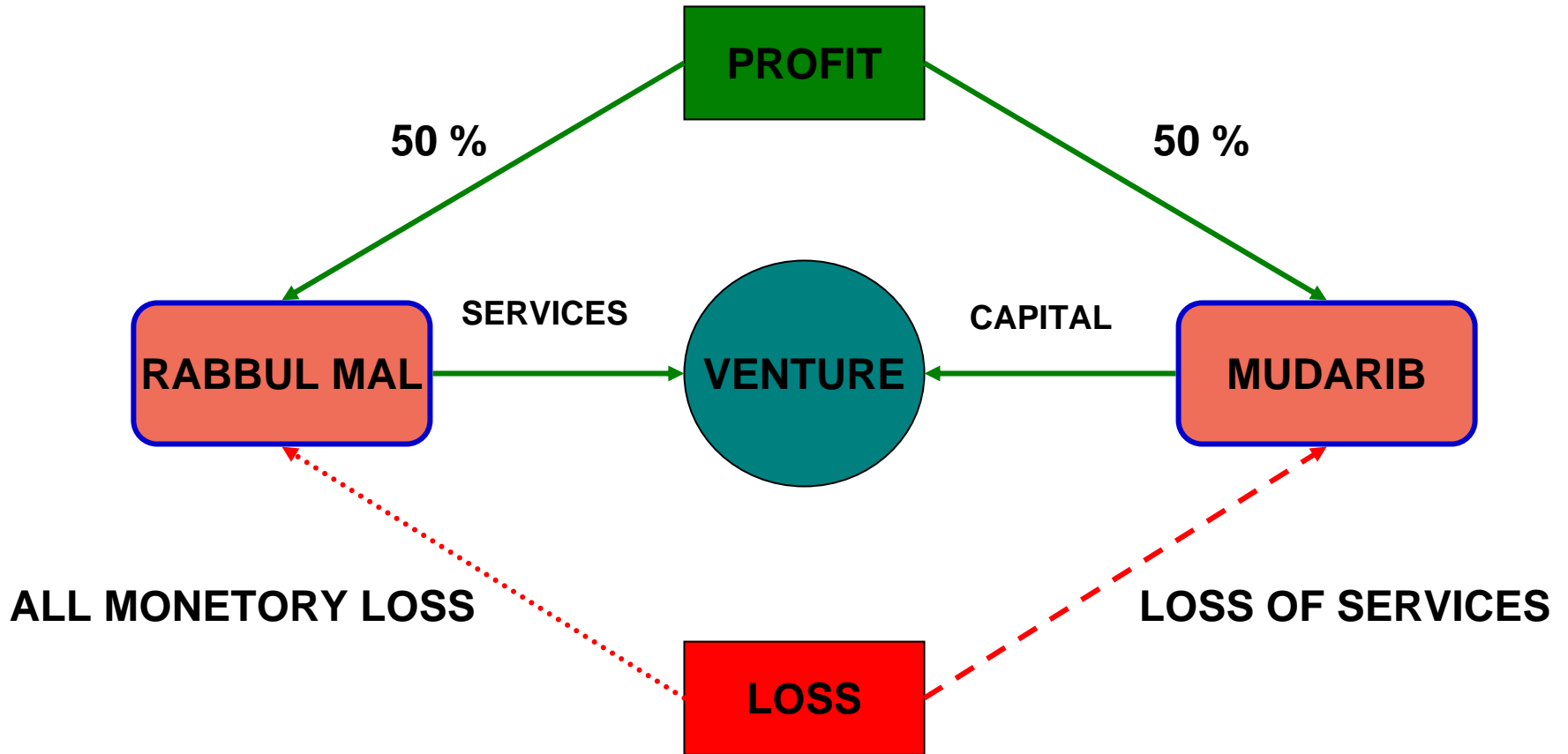


Must be according to capital ratio

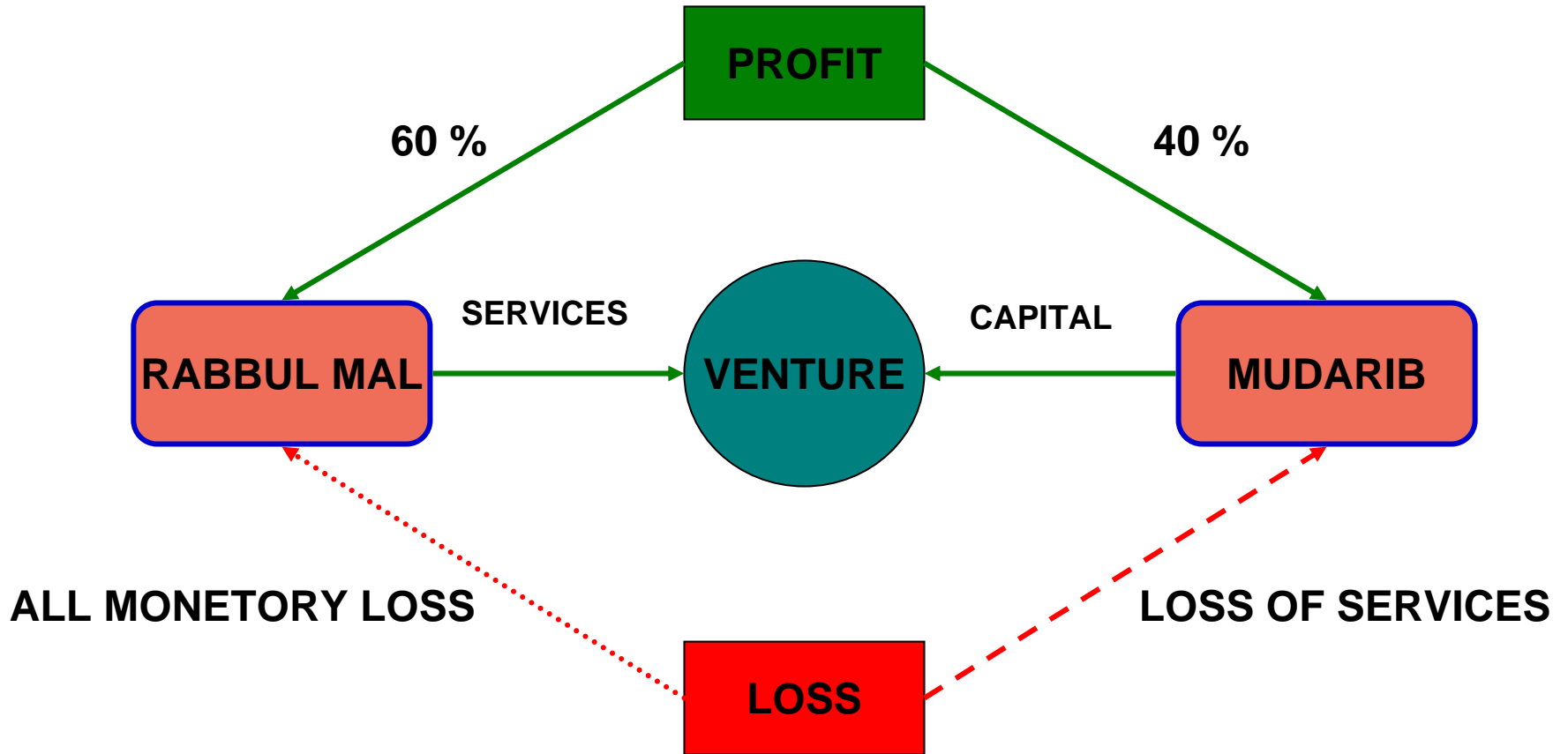
MUDARABA

- One partner (Rab al Mal) contributes capital and the other (Mudarib) contributes his skills or services to the venture
- Venture may for a fixed period or purpose
- Both share profit in pre-agreed ratio
- Loss is borne by Rab al Mal only, Mudarib loses his services

MUDARABA



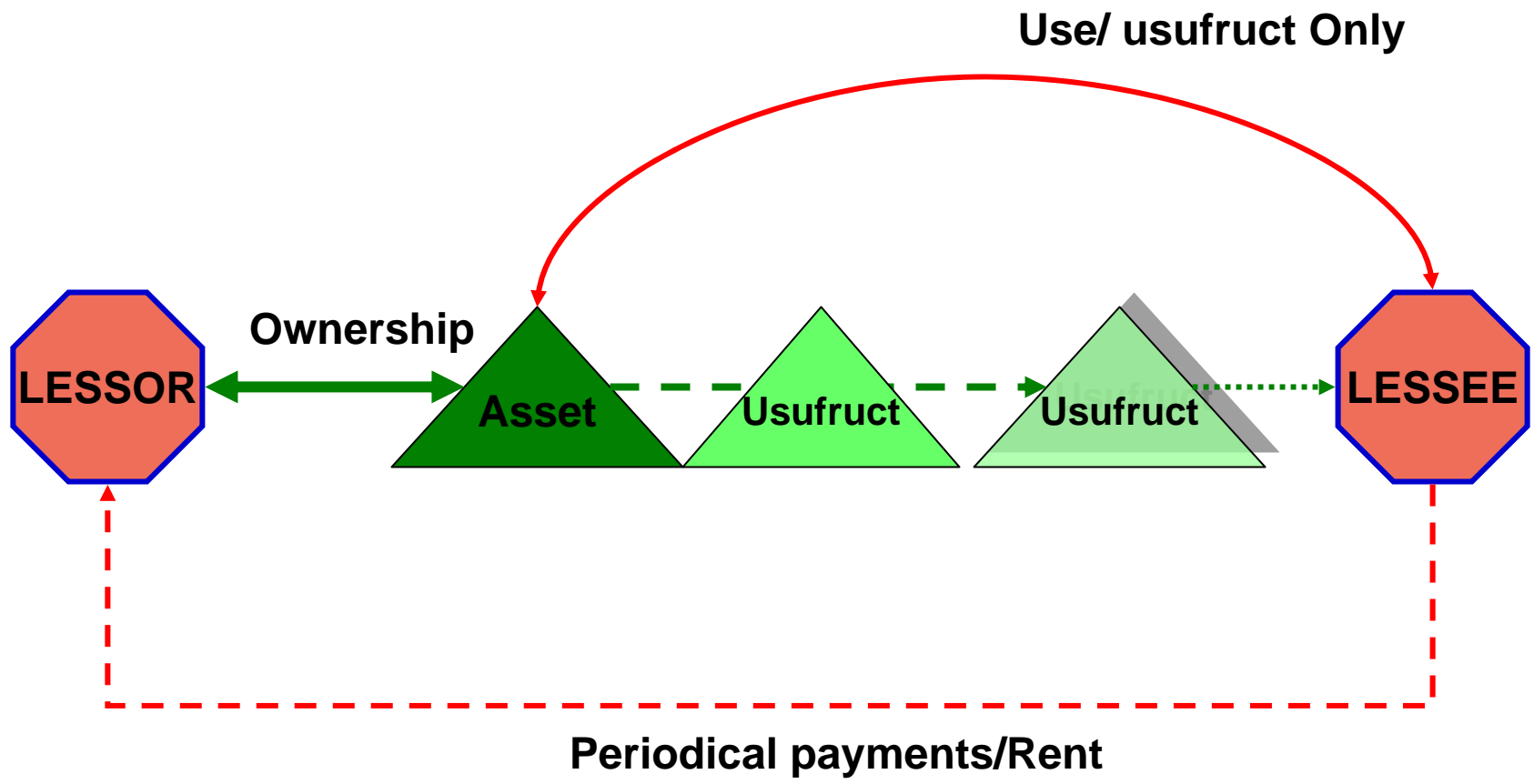
MUDARABA



IJARAH

- Usufruct of an asset is passed to other party against a periodic rent payment
- The asset must have corpus (body) and be in existence
- The asset must not be consumable in nature (should not vanish if used)
- Ownership will remain with the lessor and he will bear all the risks related to ownership

IJARAH



SALAM (Advance payment)

- It is an exception to the general principle of instant exchange of counter values in a contract of sale

SALAM (Advance payment)

- Full payment of purchase price, No deferment or installment in advance money allowed
- No loan adjustment is allowed
- Quality and quantity must be specified
- Date of delivery must be specified

MURABAHA

- Murabaha is sale of a commodity at cost plus margin; it must fulfill all the conditions of a valid sale
- It may be spot sale or a deferred/credit sale
- Deferred sale Murabaha is used as financing mode by Islamic Banks
- Deferred price becomes a debt and shall be dealt with as a loan transaction
- Price once settled at the time of sale can not be changed due to default of creditor, any thing above sale price would be *RIBA*

Conditions for Murabaha

- Since it is a sale contract; it must fulfill all the conditions of a valid sale
- The Bank should purchase the asset from a third party and not from the customer himself
- The Bank must own the asset before it sells to the customer
- The Bank must have possession (physical or constructive) i.e. it must come to its risk
- The seller must know and disclose the cost including freight, insurance and taxes etc.
- Profit may be fixed in lump sum or through agreed ratio to be charged over the cost

MURABAHA

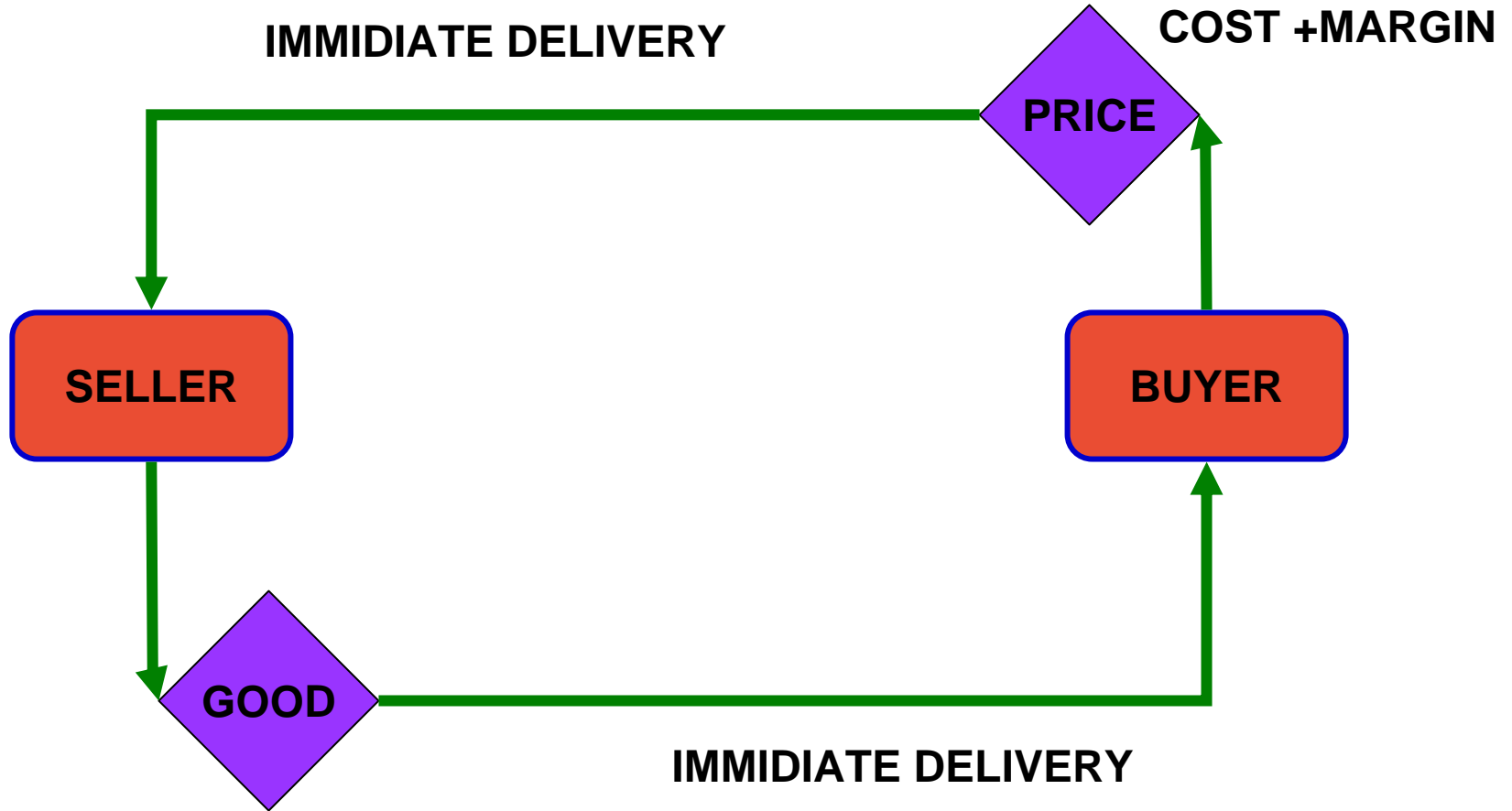
MURABAHA

CLASSICAL / SPOT

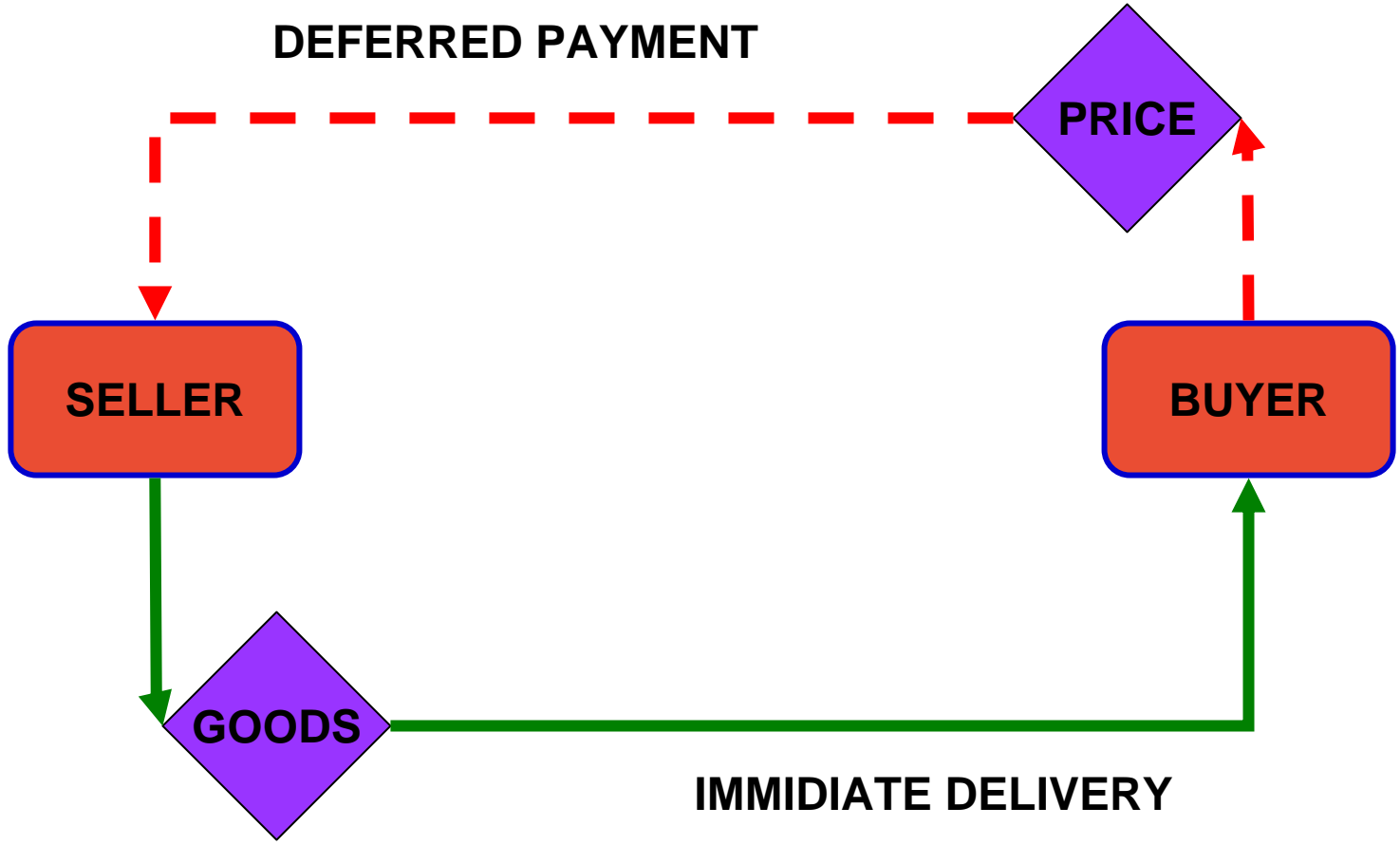
DEFERRED
with LUMP SUM
PAYMENT

DEFERRED
with INSTALLMENT
PAYMENT

CLASSICAL MURABABA



BAI' MU'JJAL (deferred sale)



MURABAHA WITH DEFERRED PAYMENT

